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A.I.D. Economic Policy Reform in Six African Countries

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Summary

Since 1985, the African Economic Policy Reform Program (AEPRP) has become the centerpiece of A.I.D.'s efforts to help African governments restructure their economies and institute new incentive systems to deal with a deteriorating economic environment. Between FY 1985 and FY 1990, A.I.D. committed $308.8 million to 19 countries under the AEPRP. In 1989 and 1990, A.I.D.'s Center for Development Information and Evaluation (CDIE) and the Africa Bureau jointly assessed the impact and effectiveness of A.I.D.-supported policy reform efforts in six African countries: Cameroon, The Gambia, Mali, Malawi, Senegal, and Uganda.

The reforms changed key policies important to the economic growth of the six countries. For example, the reforms liberalized the fertilizer market in Cameroon and Malawi; reduced government regulations in the agricultural and financial markets in The Gambia; reduced government control and regulations pervasive in the economy of Mali; improved tax administration, reduced industrial protection, and provided incentives to a moribund private sector in Senegal; and liberalized the foreign exchange system to encourage nontraditional exports in Uganda.

At the time of the evaluations, insufficient time had elapsed to make a definitive assessment of the ultimate impacts of the reforms on private sector development or overall economic growth trends. Nevertheless, the evaluations provided significant evidence of progress in implementing policy reforms and of promising trends in leading indicators of performance to date. The assessment found convincing evidence that under the right conditions, policy reforms create market incentives that can and do lead to the desired private sector responses and spur private investment and trade. However, the evaluation also found evidence that policy reform does not guarantee sustained development. Getting the prices right and creating market incentives through policy reforms may be necessary but by themselves not generally sufficient for making growth and development happen.

The case studies show that the effectiveness of the evaluated policy reform programs was reduced or counter balanced by a variety of conditions such as (1) lack of confidence by the private sector in the seriousness of the reform effort or lack of response because of generally unpromising economic conditions, (2) lack of reform

efforts in linked or related markets, (3) unanticipated external events, such as droughts or declines in international prices; (4) lack of necessary, complementary physical infrastructure, market systems, business infrastructure or institutions; or (5) efforts by politically powerful losers in the reform process to stifle reforms.

The evaluation also highlights some common misperceptions of what the policy reform process entails. For example, the time frame needed for policy reform programs to make an impact in these cases was longer than many had anticipated. Also, successful implementation of policy reform was more staff intensive than commonly perceived, requiring considerable high-level technical and analytical staff input to design, monitor, and evaluate the effort in order to keep it on track and performing well. The study found that sustainability of reform efforts depends on technical assistance being used not only directly for implementation, but also for building the host country's capacity for policy reform analyses. The policy reform efforts that built these factors into their programs performed better than those that did not.

Because of the promising performance of policy reform programs to date, A.I.D. should continue to give priority attention to and funding for these programs as a key strategic approach for achieving development objectives. Careful consideration of these evaluation lessons, especially those concerning the conditions and factors that most influence the performance of policy reform programs, should help to further improve their effectiveness in the future.

Background

The 1980s were the "lost decade" for many African countries. The world recession of 1981-1983 was the most severe in nearly 50 years. African countries faced a sharply changed economic environment: Demand for exports was down, prices for imports were high, international lenders were reluctant to lend to low-income countries, and African government interference stymied the business environment. Since their independence, most African countries had developed elaborate market controls, regulations, and subsidies, whose inappropriateness was made painfully apparent during the period of economic decline. By the mid-1980s most of these countries were seeing the downside of those protective measures: inadequate investment, inefficient industries, declining crop sales, shortages of goods, and a stagnant or declining gross national product (GNP). In the last half of the 1980s, A.I.D. committed substantial funds to support policy reforms designed to help reverse economic decline in 19 African countries, among them Cameroon, The Gambia, Mali, Malawi, Senegal, and Uganda.
In 1989 and 1990, CDIE and the Africa Bureau jointly evaluated the A.I.D.-supported reform programs in these six countries. The evaluations provide a report card on progress to date and insights into how to improve future policy reform programs.

A.I.D.'s Assistance Approach

A.I.D.-supported reform programs, which varied from country to country, all involved changing key economic policies in sectors critical to economic growth (see Box).

In Cameroon and Malawi, reforms were designed to liberalize the fertilizer market by providing fertilizer to farmers on a timely basis, at a reasonable cost. In Cameroon this meant moving toward a private, competitive fertilizer market, with a phase-down of government subsidies and controls. In Malawi the program reduced the fertilizer subsidy and foreign exchange costs by importing a variety of fertilizer that contained more nutrients and less filler. The total transport cost was reduced, thereby lowering fertilizer costs.

The Gambia program was designed to sharply reduce government regulation of agricultural and financial markets and to encourage greater private sector involvement in agricultural marketing and investment.

Reforms in Mali were designed to move the government away from a centralized economy toward one less regulated and more supportive of the private sector, and to improve efficiency in the public sector in delivering important public services.

In Senegal, reform was designed to make private industry more competitive and to make the tax system more efficient and equitable.

In Uganda, reform focused on the foreign exchange system and was designed to encourage nontraditional exports by private investors.

Findings

Most of the policy reform programs were successful at the time of the evaluation, but reforms usually took longer than expected, and many objectives were not yet fully achieved. Below are the key evaluation findings on the performance and initial impacts of the reform efforts in each of the key policy problem areas.

Performance

Price and Market Controls

Removing price and market controls generally had an immediate, positive impact as prices declined and goods became more readily, contrary to expectations in some cases, available. It is often difficult to end controls because, unlike government subsidies, price and market controls do not require an outlay of public funds and thus seem to be cost-free. As a result, they can remain in place a long time. But the evaluations found that once controls were lifted, the benefits of lifting them were clear. Only in The Gambia, where reforms were incomplete, was decontrol unsuccessful. The only disappointment, however, was that, in some cases, the private sector was still hesitant to take full advantage of new investment and market opportunities because of the uncertain political environment and reservations about the sustainability of the reforms.

In Mali, contrary to expectations, decontrol of prices did not result in higher prices. Rather, decontrol reduced the substantial costs that retailers were paying for arbitrary fines or just plain shakedowns. Evaluators found that businesses had previously built in higher profit margins to pay the fines and bribes required under the old price control system. With uncertainty, bribes, and fines eliminated, businesses could operate at lower mark-ups, which meant lower prices to customers. Those unfamiliar with the true cost of supporting an economic police force (price controllers) expected that price decontrol would entail social costs; instead it produced social benefits.

In Cameroon, the lifting of market controls ended the Government's fertilizer monopoly and the private sector was allowed to import and distribute fertilizer. The reform resulted in a steep, immediate drop in the cost of importing and delivering fertilizer to farmers. The private sector was able to do the job at a much lower cost than the public monopoly, which suffered from corruption and inefficiency. In the first 2 years, the Government was able to save $14 million through lower subsidy payments and farmers were shielded from undue price increases.

However, in The Gambia, the story was different: decontrol was not immediately successful. The private sector was allowed to compete with the government cooperative, but the cooperative had an unfair advantage because it was allowed to operate without having to either make a profit or cover its costs. Such an arrangement made it impossible for the private sector to compete with the government cooperative. The idea of letting private traders compete with a government cooperative works only if the government agency plays by the rules of the marketplace.

The Gambian financial and agricultural market reforms were designed to encourage private investment, particularly in the agricultural sector. But with agricultural prices low and the political and economic environment uncertain, investors put most of their money into short-term investments and inventories, investing very little in the agricultural sector.

The reforms in Uganda ended the government parastatals' export monopoly on noncoffee crops. Exports increased substantially as the private sector was quick to enter the export trade. In just under 2 years, the reforms generated a fivefold increase in noncoffee exports. As in The Gambia, however, the private sector is uncertain about the political and economic future and is reluctant to sink money into longer term business investments.

Subsidies and Protected Markets

The elimination of subsidies and industrial protection spurred productive efficiency but required some painful adjustments for firms that had previously been subsidized or protected from competition. In Senegal, the reforms were designed to end years of protection of the industrial private sector by opening up markets and liberalizing imports. The results were dramatic. Prices for consumer and industrial goods declined as competition brought prices down. Firms now faced competition and had to scramble to find ways to reduce costs and improve marketing. Many firms were unable to face the new competitive environment and had to cut back production or go out of business. Formal sector firms clearly suffered, but according to A.I.D.-funded surveys the informal sector, no longer discriminated against by protectionist policies that benefited the formal sector only, apparently prospered from the reforms. In the informal sector, employment, output, and profits expanded. In fact, informal sector employment appears to have expanded by about 17,000 new jobs while the formal sector lost about 10,000 jobs.

In agriculture, however, farmers reacted to change in rational but unexpected ways. For example, in Malawi, with a reduced fertilizer subsidy and higher fertilizer prices, farmers were expected to use fertilizer for higher value crops. But evaluators found that fertilizer use between crops had not changed. Fixed government procurement prices and restrictions on the types of crops grown influenced farmers' responses more than the fertilizer subsidy did. In Cameroon, under similar reform, the pattern of fertilizer usage changed but again in an unanticipated way instead of using fertilizer on the higher value coffee crops, the farmers used it for lower value food crops. The Cameroon Government had kept its coffee purchase price for coffee low and had been slow in paying farmers for coffee production, so farmers appeared to be shifting fertilizer to use on noncoffee crops. In both countries, unchanged government procurement prices and policies turned out to be more important than the fertilizer subsidy in determining patterns of fertilizer use.

Trade Controls and Red Tape

The removal of import and export controls helped improve efficiency but failure to reduce bureaucratic and administrative delays (for permits, clearances, and ministry approvals, for example) continued to plague reform efforts. In Uganda, government parastatals lost their monopoly control of noncoffee exports, private traders were allowed to export a wide range of products, and foreign exchange controls and pricing were liberalized. But many bureaucratic and procedural requirements remained that made it costly and difficult for smaller firms to enter the export market. In Mali, import quotas were greatly reduced and then abolished, and automatic import licenses were issued to cover nearly all imports. But the immediate impact was modest. Import procedures were still cumbersome, and the Government added new antifraud measures to eliminate underinvoicing measures that tended to raise costs and create uncertainty for importers.

Linked Markets and Linked Reforms

Reform in one sector is often undermined by lack of reform in a related sector or market. In general, the evaluation found that the elimination of monopolies by state-owned enterprises opened markets and allowed the private sector to compete and deliver goods at a much lower cost. But reform was often hampered by the problem of linked markets when only one was decontrolled. For example in The Gambia, farmers were unwilling to sell groundnuts to private traders and continued selling them to the government cooperative which still had a monopoly on fertilizer for fear that the cooperative would otherwise deny them access to the fertilizer. Markets for agricultural inputs and outputs were similarly linked in Cameroon, where the Government opened the sale of fertilizer to the private sector but maintained a government monopoly on purchasing coffee. Faced with a low price for coffee, farmers were reluctant to buy fertilizer to use on their coffee bushes. In Senegal the Government failed to implement complementary reforms (e.g., public utility pricing, labor regulations, credit and administrative reform), which undercut the industrial reforms supported by A.I.D.

Tax Administration

Tax reforms (to improve tax collection and provide economic incentives) appear promising, but results are uneven, and it is still too early to know if results are significant or lasting. In Mali, the Government cut corporate taxes, payroll taxes, and the sales tax to encourage private investment. It even made minor cuts in individual income taxes. Although the tax cuts initially reduced government tax revenues, the lower revenues were partially offset by improved tax collection in some areas. The Government tried to make up for the rest of the revenue loss by increasing taxes in other areas, thus creating new disincentives as it eliminated old ones. In Senegal, newly introduced reforms look promising, but it is still too early to judge results.

National Capacity for Policy Analysis and Reform

Developing the host country's capacity for policy analysis, formulation, and implementation is essential for sustainable policy reform. The A.I.D. programs in The Gambia, Mali, Senegal, and Uganda included technical assistance to implement policy reforms. But only in Uganda did A.I.D. help develop an institutional capability for policy development. The evaluations found that policy reform is a continuing process, requiring constant monitoring and adjustment as the effects of each new policy become apparent. A.I.D. technical assistance can help developing countries develop the ability to analyze and set their own policy reform agenda.

Factors Influencing Performance

Private Sector Confidence

One of the surprises of the reform process has been the slow growth of private investment. Two hypotheses have been offered to explain this failure. One hypothesis is that private investors have become so accustomed to a rapacious bureaucracy, policy flip-flops, and political instability that they are cynical about apparent reform. Thus, they continue to move their capital abroad or to engage only in short-term, relatively high-return investments. The other hypothesis is that although incentive structures have improved, failure to develop public infrastructure (such as roads, railroads, and market systems) has severely restricted profitable private investment opportunities.

If the first hypothesis is correct, there is probably relatively little that foreign assistance can do to restore private investor confidence in the short run. But if the second hypothesis is correct, there is much that a foreign donor can do. Getting governments out of activities that produce private goods and encouraging them to allocate their resources to the provision of public goods that improve the business climate can also stimulate private investment.

External Problems

In several cases, the immediate reform measures were successfully implemented but problems in another area offset much of the reform's success. The evaluations found that the broader economic environment often produced unexpected problems: for example, an overvalued exchange rate hurt export prospects; an economic slowdown and low domestic purchasing power took some of the momentum out of the reforms; inappropriate controls and prices in one area harmed reforms in another; and inadequate physical infrastructure or markets prevented the full realization of production increases. In nearly every country case examined for this survey, policy problems in one sector hampered A.I.D.-supported reforms in another. In Uganda, for example, where inadequate physical infrastructure was initially a serious obstacle to imports, repairing roads was found to be as important to export growth as were good policies.

Staff Requirements

Policy reform programs require intensive use of highly skilled professionals, not only at the analysis and negotiation stages, as previously thought, but also during implementation. Policy reform is a complex process that goes far beyond issuing a government decree. Senior management from both A.I.D. and the host government must have professionals with technical, economic, social, political, and institutional expertise to support the needed institutional changes required to implement successful policy reforms. What's more, professional A.I.D. staff such as the economist, the agricultural development officer, and others monitoring the progress of reform must be able to recognize and respond effectively to the often subtle rear-guard actions, delaying tactics, and other subterfuges mounted by those who stand to lose their special privileges as a result of the reforms.
In terms of staff resources, the fixed costs of policy reform programs are high and marginal costs are low. That is, a $50 million program does not require double the management time of a $25 million program. This appears to be more true of policy reform than of project assistance.

Time Needed

It can take 5 to 10 years for policy reform to produce major changes in agricultural markets, institutions, and the business climate. The evaluations found that policy problems can take many years to solve. It takes time for investors to trust a government that has long been hostile to their role in the economy. And the overall investment climate is often more important than changes in interest rates or policy announcements. Moreover, reform is a complicated process; many layers of related problems need analysis and correction before the desired outcome can be realized.

Donor Coordination

Donors usually agree on general principles at high-level planning meetings, but actual implementation efforts are not always mutually supportive. Donors may have conflicting approaches to development. In Senegal, for example, A.I.D. encouraged tax reform (lower taxes) to improve economic incentives, while the International Monetary Fund (IMF) pushed for increased government revenues (higher taxes). In The Gambia, A.I.D. encouraged higher, market-based interest rates, while the African Development Bank and the International Fund for Agricultural Development provided subsidized agricultural credits.

Monitoring and Evaluation

Data collection and analysis must begin early in the design of a policy reform program. The evaluations noted the importance of collecting baseline data and monitoring changes in data. Policy reform programs need an information system to measure a program's progress and impact and to provide input for the ongoing redesign of reform efforts. But most of the evaluations noted a lack of policy monitoring and evaluation capability.

Sociopolitical Considerations

Planning for the social costs of adjustment is important, even though in most country cases, adverse impacts were limited and the long-term benefits were extensive. Although reform measures can be technical in nature (prices, subsidies, interest rates), they affect social and economic interests as well. In Mali the civil service staff was cut to reduce the government deficit. But many of those who took early retirement were teachers, which left fewer teachers to help boost Mali's low school enrollment and literacy rates. In the case of Mali, targeting staff reduction to nonpriority sectors might have been preferable to indiscriminate reduction of the civil service staff.

Furthermore, policy reform entails economic adjustment and dislocations that generate social and personal costs. Of the six programs, only the one in Mali included measures to soften the adjustment process. A.I.D. helped bureaucrats displaced by cuts in the civil service staff move to the private sector. It funded business training courses, severance payments, and a loan fund for new enterprises.

The evaluations found that support from key elements in the host country was critical to successful reform. Unless all important elements of the government understand and support the reform process, potential countermeasures will negate the reform effort. In Mali reformers concentrated on eliminating one set of disincentives while government actions in another created new ones. In Senegal, the Government focused on industrial reforms to improve the competitiveness of industry, but failed to implement a set of complementary reforms necessary to the success of its efforts.

The Demonstration Effect

Policy change that can reassure skeptical government officials has a demonstration effect. It is sometimes better to start with modest reform objectives that concentrate on a manageable task, adding complementary reforms as the program develops. In Uganda, as in many developing countries, some government officials were not fully convinced at the program's inception of the value of free markets and private-sector-led growth. As a tactical measure, A.I.D. focused on a limited number of issues related to nontraditional exports. The program used a sequence of reforms to demonstrate how the private sector responds to higher foreign exchange rates and to fuller participation in production, marketing, and exports. Government officials were uniformly impressed with the private sector's performance and were willing to continue expanding its role.

Lessons Learned and Programming Implications

Although the reform programs varied from country to country, some of the lessons are applicable across the programs. Below are a series of general recommendations that A.I.D. management should consider in the design, monitoring, and evaluation of reform programs:

When planning reform programs, identify related policies and factors that might tend to defeat the objectives of policy reform. For example, eliminating subsidies clearly produces a savings in the host country government's budget, but it may not produce the expected response from firms and farmers, as the case of Malawi and Cameroon demonstrates. In these countries, unchanged government procurement prices and policies had more of an effect on farmers' decisions than did the sharply reduced fertilizer subsidy.

Consider not only the benefits of adjustment, but also the cost, including the pain for those most severely affected by reform. The structural relationships changed by the reforms have differing impacts on different people, and understanding and responding to these changes are critical to the success of the reform efforts.

Some sectors adversely affected by the reforms may require assistance to help them through the transition, as in the case of Mali's civil service. But A.I.D. should also be watchful of the reform losers (those with a vested interest in maintaining the status quo) whose attempts to protect their special privileges endangers the reforms.

Build into the program design a monitoring and impact assessment system. Such a system is necessary to help reformers measure progress, identify problems and adjust the program accordingly, and respond to the political-economy issues that arise during program implementation.

Include data collection and analysis at an early stage in the design of a policy reform program. When planning for data collection and analysis, A.I.D. should recognize the difficulties prevalent in the data-poor environments of most African countries. A.I.D. should also define the impact variables that must be tracked, keep the monitoring system focused on those variables, and resist monitoring everything and collecting all available data to avoid creating stacks and stacks of unanalyzed data.

In each country, analyze not only the controls and regulations but also the bureaucratic hurdles to be overcome. Reducing controls on imports and exports produced clear benefits, but usually, even after controls were lifted, a thicket of ministerial approvals, forms, and clearances remained, delaying and hindering traders. Extensive analysis ofbureaucratic procedures and processes may be needed to identify all the barnacles and the related cost in time and money to businesses.

Keep the policy horizon broad to anticipate external problems.An overvaluedexchange rate, for example, hurts export prospects or an economic slowdown and low domestic purchasing power can take the momentum out of the ongoing reforms.

Put adequate time and energy into developing and implementing analytically sound reform programs that can respond quickly to changing conditions. In any movement to free markets, mistakes will be made as participants learn the rules of a new system. The process of reform and the transition to free markets is difficult because special privileges in both the public and private sector are threatened. A.I.D. needs to determine how quickly the private sector can step in to replace the public sector, how rapidly to eliminate subsidies, and how to design a flexible transition to a free market so that liberalization is not reversed.

Avoid becoming too heavily involved in market decisions or allocations. A.I.D. should encourage rapid decontrol of markets. Managed markets with special subsidies and allocations create special interest groups who will oppose changes that threaten their privileged positions. A policy reform program should not create new privileges and new subsidies. A.I.D should not become part of a new subsidy allocation system.

Include the necessary staff, not only for upfront planning and analysis but also for implementation. Consider the adequacy of host government management for the implementation of policy reform and where necessary provide technical assistance to strengthen host country capacity.

Think of multiyear reform programs that may take 5 years or more to complete. In many cases a phased process would make the most sense.

This would mean starting with a few manageable reforms, implementing them, and then tackling other reforms linked to those earlier efforts.

Ensure donor coordination. A.I.D. needs to work closely with other donors at all stages of program development, design, and implementation not just during program development and design.

Outstanding Issues

Interference with markets, even in the name of reform, may delay the movement toward a free market. In Uganda, A.I.D. provided CIP funds at the official exchange rate, although the parallel rate was much higher. Importers were eager to receive a CIP allocation, because imports were scarce and importers with CIPs were receiving cheap foreign exchange. But only a few importers were lucky enough to receive the CIP imports; the others had to pay the much higher free-market rates.

In both Cameroon and Uganda, the USAID Missions became heavily involved in managing the reform process. In Cameroon, the Mission and the Cameroon Government assumed a major role in managing fertilizer market prices, subsidies, and allocations. This prolonged the quasi-free market stage and delayed the transition to a free market. In Uganda, the Mission administratively controlled CIP allocations--choosing who would be allowed to import which commodities. This overinvolvement in market management delayed movement toward a free market.

There is always a danger that the transition from controlled free markets may be rough, with shortages and wild price movements as the economy learns to adjust to free market forces. Clearly a transitional period is required. The question is how long should the transition be and to what extent should A.I.D. and the host government manage and direct the transition to a truly free market. The danger is that interference and controls will unduly prolong and possibly prevent the movement to free markets. In the Cameroon and Uganda cases, the evaluations concluded that the USAID Missions were overinvolved in managing market prices and market allocations. The Missions, however, did not accept that view. They felt that there was a need for a slow and carefully phased movement toward free markets.

This summary is based on a report prepared by Joseph Lieberson entitled A.I.D. Economic Policy Reform Programs in Africa: A Synthesis of Findings From Six Evaluations, A.I.D. Program and Operations Assessment Report No. 1, December 1991. The views and interpretations are those of the author and are not necessarily those of the Agency for International Development. Any comments or inquiries about the report should be sent to the Office of Evaluation, Center for Development Information and Evaluation, Directorate for Policy, Agency for International Development, SA-18, Room 220 Pubs., Washington, DC 20523-1802.